

VISIT...

LANZAROTE
Caliente.COM

Activities

Module Two: Activity 1 - "Name That Ax"



- Being Able to Spot the Market Maker who has the most Buying/Selling Activity at a Given Point in Time on Level 2 Is an Important Daytrading Skill
- Following the ax is a relatively safe way to play stocks.
- This activity is designed to help you with your "ax recognition" and daytrading skills.

The GOAL for this activity is for you to be able to **correctly** identify who the "ax" market maker is in a given stock using your Level 2 screen.

Directions:

1. Choose 1 stock to watch all day in a Level 2 window that has an average daily volume >3million shares. Do not pick a DELL/CSCO/INTC etc. that has ask/bid columns 5-10 market makers wide; instead Choose a stock who's level 2 inside bid ask averages from 1-4 market makers wide with volume over 3Mil shares and an intraday trading range of at least 5% (eg \$1 on a \$20 stock).
2. Carefully watch the level 2 action: premarket, of the two, is it market makers **or** chippies on ARCA/INCA/SLD etc. the main player premarket? Which one is moving the price?
3. After the market opens, watch the stock for a half hour or so and see if you can determine which market maker is frequently on the inside bid or ask. Make sure to follow a major market maker like SBSH MLCO MSCO GSCO (not hrzg/sllkc etc).
4. Write down the following:
 - stock's closing price from yesterday,
 - today's opening price,
 - the name of the market maker you think is the "ax" for the time period you're watching,
 - number of times this market maker is at the "best bid" or "best ask" in a 2-hour timeframe (use a simple checksheet to keep track of this)
 - Which of the following important trading signals do you observe? A) The Market Maker is **Buying in Size** (he keeps refreshing his bid, and you see him buying more than 10K shares (or more than 12-15 transactions) in time and sales at the same price level); B) The Market Maker is **Selling In Size**; you see him stay at the inside ask and sell more than 10K shares at a given price level, **Headfakes and Switching** from the bid to the ask repeatedly (he's probably not the ax if he doesn't buy or sell a lot, jumping around).
 - Finally, develop a trading strategy based on your observations and consider buying or selling in response to the "ax's" buying and selling. Try to shadow the market makers' movement. Examples of axes I follow: SBSH for NOVL price movement, MSCO for SPLS.
 - Note that the ax may frequently change throughout the day, or from day to day. Look for whoever's buying or selling a lot of stock in a given timeframe, and follow that traders' lead.
 - Practice trading small sizes of 100-300 shares by following the ax after papertrading for several days with this ax. See how it works for you. Good trading.
4. Write down the following:

Examples:

Looking at this Level 2 chart doesn't tell you much without seeing it "in action", but for now let's assume that GSCO is the ax on SBUX and is buying a lot of stock here. How would you trade it? Join his bid at the ask, use a larger size (or increment the bid by 1/32) to frontrun him? Wait? Check Time and Sales? It all depends on the price action and technical signals on your 1-minute SBUX chart.

Looking at this Level 2 chart doesn't tell you much without seeing it "in action", but for now let's assume that GSCO is the ax on SBUX and is buying a lot of stock here. How would you trade it? Join his bid at the ask, use a larger size (or increment the bid by 1/32) to frontrun him? Wait? Check Time and Sales? It all depends on the price action and technical signals on your 1-minute SBUX chart.

The immediate "battle" is between GSCO and whoever's selling on INCA (Instinet). The players line up under these two for the moment, no real strong mm's next to this action; SBSH and MLCO are each a couple of levels down. It's an indeterminate L2 window until we see a pattern of buying or selling in the time & sales window.

If INCA fades and we just have ISLD/NITE left, with GSCO staying strong you might BID SBUX 27 5/8 1100 shares or 27 21/32 500 shares etc. to frontrun. The battle goes on.

SBUX + 27 5/8 b 27 5/8 a 27 11/16 10 x 44 2:13M 15:38									
MMID	Bid	B...	MMID	Ask	A...				
GSCO	27 5/8	10	INCA	27 11/16	44	27 5/8	600		
FBCO	27 5/8	10	ISLD	27 11/16	17	27 5/8	100		
BRUT	27 5/8	6	NITE	27 11/16	1	27 11/16	500		
STRK	27 5/8	5	DBKS	27 3/4	10	27 11/16	1,500		
NITE	27 9/16	1	SELZ	27 3/4	1	27 5/8	100		
SHWD	27 9/16	1	DEAN	27 3/4	1	27 5/8	800		
FLTT	27 9/16	1	SHWD	27 3/4	1	27 5/8	100		
MADF	27 9/16	1	MONT	27 3/4	1	27 5/8	200		
INCA	27 1/2	10	SBSH	27 13/16	10	27 5/8	200		
SBSH	27 1/2	5	MLCO	27 13/16	10	27 5/8	300		
MONT	27 1/2	1	LEHM	27 13/16	1	27 11/16	100		
JPMS	27 1/2	1	JPMS	27 13/16	1	27 11/16	500		
CANT	27 7/16	1	MWSE	27 7/8	14	27 11/16	100		
WBLR	27 7/16	1	OLDE	27 7/8	10	27 5/8	300		
DBKS	27 3/8	10	MSCO	27 7/8	10	27 11/16	1,000		

Module Two

Comprehensive Level 2 Trading Techniques:

Back to
MODULE 2

Activities

Module Two: Activity 2 - "Finding T&S Support and Resistance"



- Next to "Being Able to Keep Small Stops", this has my vote for the Most Important Daytrading Skill to Develop
- Reading the trend of the sales going off in T&S is the best way to see what's really going with the stock's price movement.
- The **pace** (how many trades are going off, is it faster than it was 20 minutes ago?) as well as the **ratio & size** of trades going off at the bid vs. ask is important to keep an eye on.

24 1/2	500
24 7/16	100
24 7/16	200
24 7/16	1,000
24 7/16	500
24 7/16	1,000
24 7/16	200
24 7/16	200
24 1/2	200
24 1/2	200
24 1/2	500
24 1/2	100
24 1/2	100
24 1/2	200
24 1/2	500
24 1/2	100

The GOAL for this activity is to help you become skilled at determining when a stock's price is about to "pivot", or change and go in the other direction based on your watching trades go off in the time and sales window.

Directions:

1. Choose a stock to watch from 9:30 am til 11:00 am in a time and sales window. (By the way, I'd disable the "time" part of time & sales if I was you, there is no reason to see the time that a trade goes off at, it is distracting data that you don't want to have).
2. Keep an eye on the 1-minute tick chart as well, especially from 10:00am til 11:00am
3. At first, I want to encourage you to **just get a feel for the rhythm of the stock** during the different 10-20 minute cycles that it buys, sells, buys and sells. The rhythm means the pace of the trades, how fast are they going off? Are there big blocks in there (over 5K shares), or are they mostly 100-1K size trades? How fast is the tape printing?

24 1/2	500
24 7/16	100
24 7/16	200
24 7/16	1,000
24 7/16	500
24 7/16	1,000
24 7/16	200
24 7/16	200
24 1/2	200
24 1/2	200
24 1/2	500
24 1/2	100
24 1/2	100
24 1/2	200
24 1/2	500
24 1/2	100

4. Next, I want you to **look for directional trends** in the t&s display. How long does each "run" in one direction or the other last? Do you see "in-between" trades going off at a price in between the bid and ask, and is it signaling a pivot in the price?
5. The most important skill to develop here is to find the difference between a **"Real Directional Change"** in buying vs selling versus the **"noise"** of individual trades, or small flurries of 5-7 trades, that are part of the trading pattern.
6. **As the stock gains momentum and you see more and more buyers (or sellers) coming in, try to estimate how long, and for how many spreads, the directional change will last in the time and sales window.**
7. Write down the following:
 - **specific times that you believe the stock is about to change direction as you watch the t&s window** (e.g., its 9:50 and, watching the t&s you think to yourself "ok I think it's going to head down now", so you write 9:50 NOVL going down on a pad of paper).
 - the **actual times** that it really did change direction that morning
 - **how far you think the direction change may be good for**, maximum (eg "ok NOVL's going down, based on chart support, L2 and t&s momentum I think it may be good for 3/8 point change maximum")
 - the **actual amount of price change** the stock went in the direction after the "pivot"

Over time, by practicing this way, you should gain a feel for the directional support and resistance using time and sales. "Reading the tape" is the most important observational skill you can develop as a trader; the "small stops" is the most important trade management skill you can develop.

Again, I would strongly recommend that you choose 2-3 stocks that you want to make a living daytrading from; you need a core of stocks that you know like the back of your hand. Some stocks are more difficult to trade than others, definitely avoid the most actives, as these tend to attract the best traders and have low-%age volatility. [See my latest 4-monitor esignal and cyberx setup for a look at the stocks I was following in January 2000](#) (note: ARIA/TIVO were just plays for setup for a look at the stocks I was following in January 2000 (note: ARIA/TIVO were just plays for that day, some of the others like CIEN NOVL DCLK are my core trading stocks).

Your success at "tape-reading" is determined by your ability to correctly identify when the "tide is about to turn" in the opposite direction, so that you can a) buy bottoms and b) sell/short tops. Invest a lot of time in watching the tape for a couple of stocks you want to trade for a living, from 9:30am-11:00am and perhaps 2:30pm til 4:pm. Don't burn yourself out by watching the tape all day. Best wishes!

Module Two

Comprehensive Level 2 Trading Techniques:

Back to
MODULE 2

Activities

Module Two: Activity 3 - "Reading the Outside Bid and Ask"



- As a leading indicator, it's useful to learn how to trade in response to the strength or weakness you see in the outside bid and ask bands in your Level 2 window. There's 2 patterns to watch for:
 1. Seeing movement of mms from the 1st outside level (green band) to the inside (yellow band) indicates that they want to lock in their buys/sells at this price level.
 2. The other pattern to look for is the width of the green band (number of market participants) either increasing or decreasing in response to a breakthrough or breakdown past a key support/resistance level.

24 7/16	200
24 7/16	1.00K
24 7/16	500
24 7/16	1.00K
24 7/16	200
24 7/16	200
24 1/2	200
24 1/2	500
24 1/2	100
24 1/2	200
24 1/2	500
24 1/2	100
24 1/2	200
24 1/2	500
24 1/2	100

The GOAL for this activity is to help you become familiar with how to look at the entire Level 2 window as a system, including the outside bid/ask bands. Of course, T&S is still the most important indicator. Use the activity of mms in the outside L2 bands as a secondary leading (early warning)- type trade direction indicator.

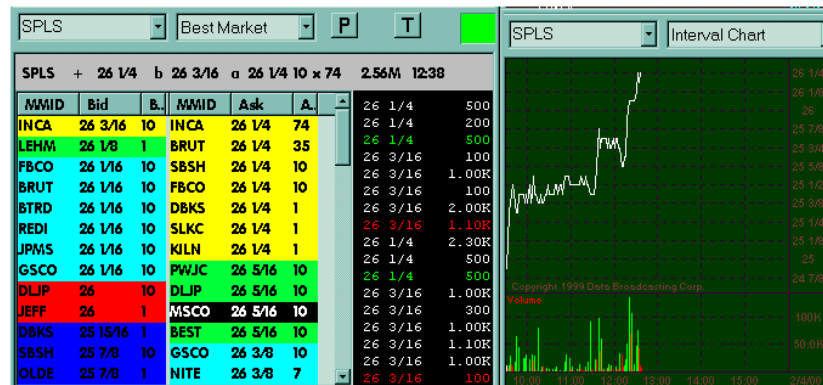
Directions:

1. Choose a stock to watch from 9:30 am til 11:00 am in a level 2 window
2. Identify the "most important market makers" for this stock based on who's buying and selling on the inside (yellow) bands initially (with first preference given to MLCO MSCO SBSH GSCO, as usual).

3. The most important skill to develop here is to see how the activity of the market makers and ECN's in the green (1st outside) band affect the short-term momentum trend of the stock price.
4. This is yet another tool that you should add to your bag of trading tricks, it is yet another Level 2 trading indicator an experienced trader watches to help assess the momentum of the stock.

Quick L2 trading example: here you see a bearish setup as far as the 1st outside (green) band goes: LEHM bid 1 vs 4 market makers each offering 10 at the ask means I'd think this stock would go down to 26 1/16 before it will go up to 26 3/8.

Remember, it's dynamic, so respond with your trades in accordance with the patterns of buying and selling strength & weakness using charts, T&S and L2.



Of course, the selling pressure in the inside ask is also bearish, and T&S is mixed, so it's pretty obvious in this example that the stock will retrace a bit. For your stock, check the pattern in the green band to see where the other traders are lining up their bids and offers, using it to help time your trade entries and exits.

Module Two

Comprehensive Level 2 Trading Techniques:

[Back to MODULE 2](#)

Activities

Module Two: Activity 4 - "When the Market Maker Flips Over"



- Often times you'll see a market maker flip from the inside bid to an outside ask level, or vice versa. This indicates he's "through" with the stock in the direction he was playing it, for the time being (maybe a few minutes or so), and gives you an indicator that you might want to bail out of the trade at that time.
- Once a market maker has finished selling (or buying) for the moment, you can mimic his trade direction, again with confirmations from T&S and your 1-minute charts, to gain a momentum edge on other traders.
- As always, be careful to watch the tape, as he may be fooling around with posted bids/asks to give the appearance of buying or selling when his true direction is routed through an ECN, however this isn't as likely for the 4 major mms we've discussed: MSCO MLCO GSCO SBSH.
- Below is a rough animation of the pattern to watch for: MLCO was on the ask (looking like a buyer), then he flips over the ask (now he's a seller); if you're in long then you might want to consider selling as well, if the T&S confirms net selling.

Notice how MLCO flips over to the ask in this rough animation we constructed. If a major mm like MLCO and both major ECNs (ISLD/INCA) are selling, I wouldn't be holding long here.

NETA	-	23 1/2	b	23 1/2	a	23 9/16	10 x 20	1.38M	12:35
MMID	Bid	B...	MMID	Ask	A...				
MLCO	23 1/2	10	ISLD	23 9/16	20			23 1/2	300
NITE	23 1/2	10	INCA	23 9/16	1			23 1/2	100
MADF	23 1/2	10	BTRD	23 11/16	5			23 9/16	1.00K
REDI	23 1/2	4	BRUT	23 11/16	5			23 1/2	400
MASH	23 1/2	3	MSCO	23 3/4	10			23 1/2	100
OLDE	23 7/16	10	LEHM	23 3/4	1			23 9/16	400
MSCO	23 7/16	10	GSCO	23 7/8	10			23 9/16	100
SLKC	23 7/16	10	NFSC	23 7/8	1			23 5/8	1.00K
BRUT	23 7/16	1	MONT	23 7/8	1			23 5/8	1.00K
ISLD	23 3/8	10	FBCO	23 7/8	1			23 3/4	2.50K
DEAN	23 3/8	5	HRZG	23 15/16	15			23 5/8	500

The GOAL for this activity is to help you learn to spot reversals (or pivots) in price direction based on what you see a major market maker doing when he flips from being a buyer to a seller (or vice versa) on the inside bid/ask of a level 2 window.

Directions:

1. Choose several stocks to watch from 9:30 am til 11:00 am in level 2 windows.
2. Identify the "most important market maker" for these stocks based on who's buying and selling on the inside (yellow) bands initially (with first preference given to MLCO MSCO SBSH GSCO).
3. See if you can detect any reversals in market makers' bias towards buying or selling, based on their "flipping" back and forth from the inside bid and ask.
4. As we saw earlier, you can also look for trends in where they are playing their trade box, eg if they drop their bids or raise their asks etc. This activity is to help you see abrupt pivots, or directional changes, in their buying or selling activity.
5. One more of the market makers' behaviors exposed for our DTU traders!
6. After seeing a reversal, follow the T&S to see if it holds, and to see if the market maker himself stays true to his reversed position for any length of time. Sometimes, they are indecisive and may flip back and forth, but they will usually hold through at least a spread or two of direction before changing from being a buyer to a seller or vice versa.
7. Once you've identified a pivot that holds true, see if you could papertrade it accurately, would you join the market maker in his now-changed position in the stock, and if so, will it hold long enough for you to make at least a few spreads' profit by it?